Pensions at a Glance 2015

JAPAN

OECD

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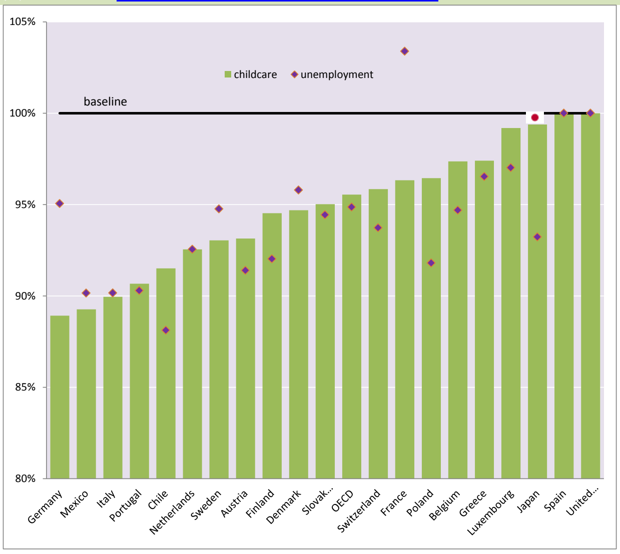
Key findings

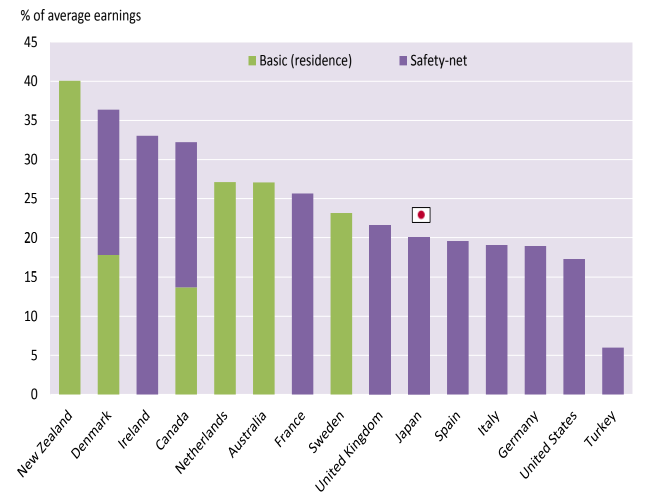
- **The finances of the public pension systems are under pressure from different fronts.** Several measures to improve the social security and tax systems are gradually implemented.
- **The number of years of contributions required to be eligible for a full basic pension is high at 40 years. Yet, at** 16% of average earnings the level of benefit is low in comparison to many countries, with the OECD average at 20%. In contrast, the value of the safety-net benefit is around the OECD average.
- **Around one-third of Japanese women aged between 25 and 54 are employed part-time, 50% above the OECD average.** The value for men is just above 5% and is equal to the OECD average.
- **Relatively short interruptions to care for children are well covered in Japan as they will still result in a pension close to that of a full-career worker.** The contribution gap will have a larger effect for unemployment-related absences.
- **Life expectancy at age 65 is the highest in Japan**. It is projected to remain so throughout the next 50 years, then reaching 30 years for women and 24 years for men, which is four years more in both cases than the OECD average.
- **Elderly poverty is still an issue.** The rate is seven percentage points higher than the OECD average and three percentage points higher than for that of the overall population.

Figure 1: Childcare and unemployment effects on future pension entitlements



[PAG2015 Figure 3.13]

Figure 2: Value of non-contributory pensions



[PAG2015 Figure 2.6]

Why is it important for Japan?

Government gross financial liabilities (debt) increased from 55% of GDP in 2007 to 88% in 2014 on average across OECD countries. But for Japan it rose from 162% to 220%, by far the highest level in the OECD. Spending on public pensions more than doubled as a share of GDP over the last twenty years, from 4.8% in 1990 to 11.2% during the years 2010-2015. The finances of the public pension system are strained by several factors. Japan is the demographically oldest OECD country, with 47 individuals aged 65 and over for 100 persons of working age in 2015. The ageing process is expected to continue, driven by high life expectancy and low fertility rates, with the demographic dependency ratio reaching 77 by 2075.

With the application of the macroeconomic indexation, i.e. the adjustment of pension benefits based on changes in the number of contributors and gains in life expectancy together, pension spending is projected to fall to 9.9% in 2025 through a decline of about 6 percentage points in the pension replacement rate.

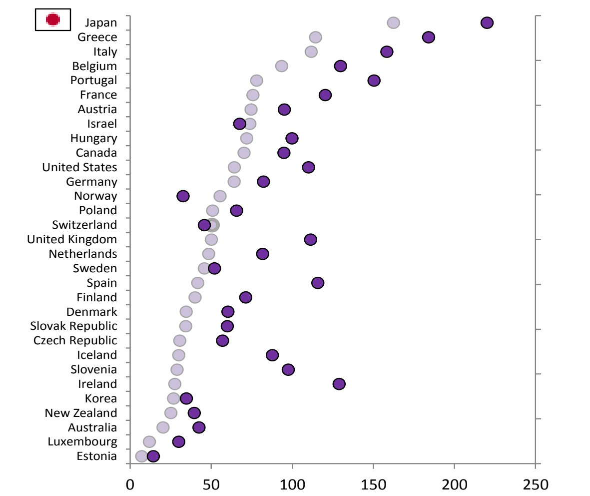
Despite the gradual increase in contribution rates, from 13.6% in 2004 to 18.3% in 2017, and the longest working life in Japan, new labour market entrants at average wage will have one of the lowest replacement rates in the OECD.

The poverty rate among the elderly declined from 22% in the mid-2000s to 19% in 2011, still well above the OECD average. Public pensions have certainly protected people against old-age poverty, but retirement-income adequacy may still be an issue.

The government is currently tackling the dualism of the labour market with several measures aimed to reduce differences in the treatment between regular and non-regular workers (primarily women and youth), who are most likely to be excluded from pension coverage. For example from April 2017 the minimum qualifying period for the old-age basic pension will decrease from 25 to 10 years increasing coverage and benefiting short-career workers. In addition, the employees' pension insurance will be extended to cover more part-time workers from October 2016 (i.e. for those working at least 20 hours a week rather than 30 previously). Since October 2015, low-income pensioners with annual pension benefits of less than JPY 780,000 are entitled to a supplementary monthly benefit. Women on maternity leave have had an increase their disposable income as they have been exempt from employees' pension contributions since April 2014.

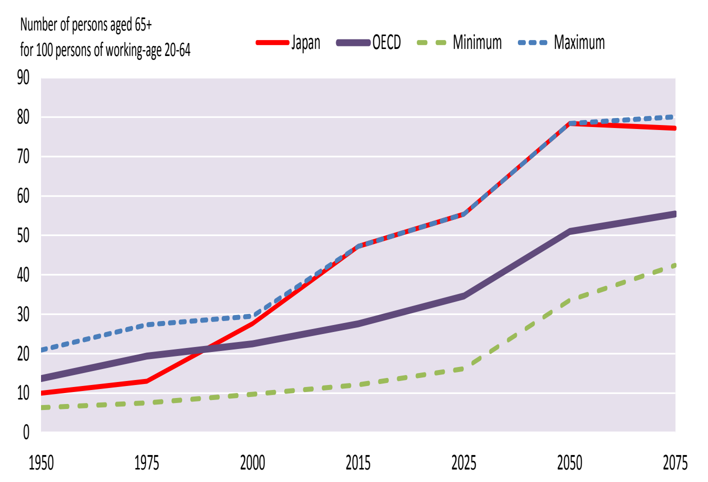
Even though the impact on pension entitlements of absences related to childcare are relatively well cushioned for future retirees, it is much less so for unemployment periods. Hence, the very long and unchanged contribution period required of 40 years) to obtain the full first-tier pension benefits may make it difficult for people with long career-breaks or shorter working lives to qualify for adequate benefit levels.

Figure 3: Pre- and post-crisis government gross liabilities



[PAG2015 Figure 1.5]

Figure 4: Old age dependency ratio



[PAG2015 Table 7.5]

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2015 Pension Policy Notes

JAPAN

- **Increase the accrual rate to raise earnings-related pensions.**
- **Increase the retirement age and link it to life expectancy gains.**

The mandatory pension system provides low benefit levels. The pension system consists of a basic and an earnings-related component, with a social assistance benefit for the most vulnerable. The full basic pension amounts to about 16% of average earnings and it is reduced pro-rata for contribution periods below 40 years, with a minimum of 25 years being reduced to 10 years from April 2017; eligibility does not require stopping work. The second tier, mandatory earnings-related pension has an accrual rate of 0.55% for each year up to a contribution ceiling around 150% of average earnings. The combination of these two pillars generates future replacement rates that are low in comparison to the OECD average across all earnings levels. Low earners (50% of average) with a full career can expect a gross replacement rate of 49%, and average earners 35% compared to the OECD averages of 65% and 53%, respectively. Overall, the relative average income of people aged over 65 (versus that of the whole population) is above the OECD average based on late 2000s data. However, the old-age poverty rate is the sixth highest in the OECD and is 3.4 percentage points above the poverty rate for the total population.

Key indicators: Japan and OECD average

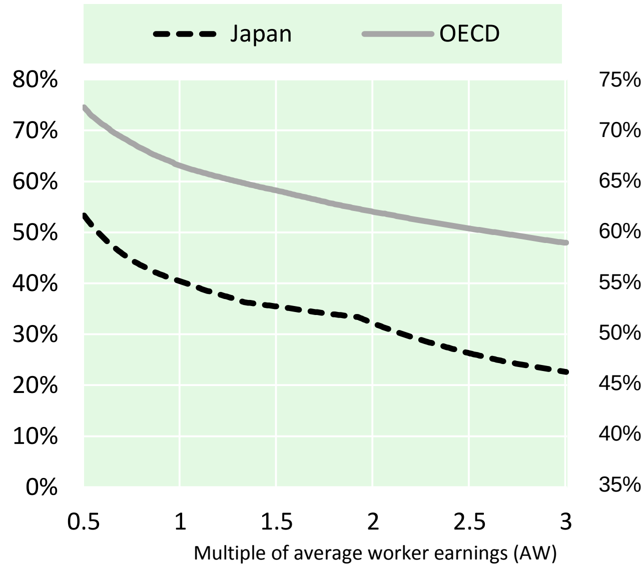
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0	65.0	65.0	65.0			
Retirement age	65.0	65.0	65.0	65.0	62.9 (61.8)	65.0	64.6 (64.4)
Net replacement rate, avg earner						40.4	63.0 (62.6)
Total mandatory contribution rate		16.5	13.9	17.5	19.1		
Total pension spending, % of GDP	4.9	6.6	12.4	15.1	10.3		
Public pension spending, % of GDP	4.8	6.3	9.8	11.8	8.4		
Public debt, % of GDP	71	88	170	229	115		
employment rate 55-64, %	78.8 (44.4)	80.8 (47.5)	78.9 (49.4)	81.5 (56.1)	66.1 (49.1)		
Labour-market exit age	69.8 (66.0)	71.1 (66.1)	69.4 (66.2)	69.3 (67.6)	64.6 (63.1)		
Old-age poverty rate, %	23.1	23.0	22.0	19.4	12.6		
Life expectancy at 65, years	16.0 (19.6)	17.0 (21.7)	18.5 (23.6)	19.5 (24.5)	18.4 (21.5)	23.8 (29.0)	22.9 (25.9)
Old-age dependency ratio	16.8	23.0	32.4	47.0	27.9	79.3	57.2
Fertility rate	1.7	1.4	1.3	1.5	1.7	1.7	1.8

Note. The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

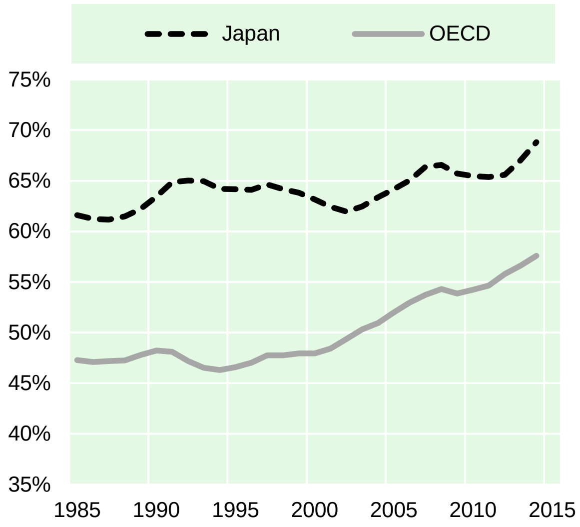
The government has passed legislation to prevent the formation of new employee pension funds. It has been possible for employers with more than 1,000 employees to contract out of the public earnings-related scheme since 1966 and establish their own employee pension fund. Whilst one objective was to achieve high returns, around 40% of these funds have been underperforming and cannot reach the target of paying 150% of the minimum reserve, i.e. the amount offered by the public earnings-related scheme. Under the April 2014 law these underperforming funds must dissolve, whilst the others will have to pass an annual performance test with employers having 30 years if needed to make up any shortfall. In addition, legislation passed in 2011 encourages further participation in the voluntary defined-contribution scheme. Employees can now make increased contributions up to the level of contributions chosen by their employer, and coverage has been expanded up to age 65 rather than age 60 previously.

Financial sustainability issues of the pension system remain. With contribution rates increasing to 9.15% for both employees and employers more revenue will be gathered. However government debt has increased to over 220% of GDP and pension expenditure is about 12% of GDP, though it is projected to fall to 10% by 2025. Recent debate has suggested raising the level of taxes paid by pensioners, thereby increasing revenues and improving generational fairness. But with replacement rates being low compared to other OECD countries pension adequacy would be reduced even further.

Long-term net replacement rates (%), by earnings level



Employment rate for those aged 55-64



Sources: OECD pension models; OECD Employment Outlook

Higher pension eligibility age with increased benefits will be required to ensure an adequate income for pensioners. Many workers in Japan already continue to work beyond the normal retirement age; the effective age of labour market exit is four years above the pension age for men and three years higher for women. As it is possible to combine being employed and receiving pension benefit, subject to income tests, government expenditure could be reduced by increasing the retirement age beyond age 65. This may not require substantial changes in labour market practice as there is already a culture of employing older workers. Currently 82% of men aged 55-64 are employed compared to 66% in the OECD on average. The share of women in this age group working is much lower at 56%, suggesting that there is room to increase women's labour market participation, even if it is seven percentage points above the OECD average. An initial increase in the retirement age to 67, and further changes in line with life expectancy gains would bring the retirement age in line with many OECD countries and would further reduce public expenditure. Furthermore the accrual rate from the earnings-related component is very low in comparison with other countries, even when taking into account contribution levels. Currently a contribution of 17.5% of earnings while financing half of the basic pension is associated with an annual accrual rate of only 0.55%. By comparison a contribution rate of 12.4% results in an accrual of 0.75% in the United States, and a 18.9% contribution rate in Germany gives a long-term accrual of 0.97%. In Japan, earnings-related benefits are low because the accrual rate is low given the rate of contributions.

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